September 14, 2017

Mergers and Acquisitions

These days mark a flurry of merger and acquisition activity. Typically, the parties focus on tangible assets and monetary figures. However, many concerns surround employees and their benefits such as retirement plans, paid time off accruals, health insurance, and flexible spending accounts. Employees don't want to lose benefits they've earned and funded. Often, aside from job retention, employees' first concerns when a merger or acquisition is announced center around benefits.

Fortunately, the IRS agrees with employees. Benefits shouldn't have to be squandered just because a company has merged with or been purchased in an asset sale by another company. Participants who elected to reduce their salary to contribute to healthcare flexible spending accounts (FSAs) for unreimbursed medical expenses need assurances that their healthcare FSA will be kept whole. This great tax savings for employees is sometimes overlooked in all the details of a merger or acquisition (M&A) transaction.

Generally, at the time of the merger or acquisition, employee healthcare FSAs fall into two categories: Employees who have money in their accounts, but not enough expenses incurred to draw all the funds, and participants who have received reimbursements in excess of their year-to-date contributions. The IRS uses **Revenue Ruling 2002-32** to explain exactly how to transfer those balances to the new employer.

By using specific facts and circumstances within the revenue ruling, the IRS guides the buyer and the seller in an asset sale on continuation of participants' healthcare FSA coverage when they become the buyer's employees. However, if the acquisition is a stock sale, benefits continue as is unhindered.

The first example allows for continuation of coverage under the seller's healthcare FSA with salary redirections made under the buyer's plan, while the second example illustrates how coverage and salary reductions are handed off to the buyer.

Coverage Continues Under Seller's Plan

The facts in this company asset sale are as follows:

1. The selling company maintains a healthcare FSA plan.
2. During the plan year, a buyer acquires a portion of the seller's assets.
3. The seller's employees are terminated and become the buyer's employees.

The two parties agree that transferred employees will continue in the seller's healthcare FSA plan and salary reductions made by the buyer's new employees for the healthcare FSA will continue as if made under the seller's plan. The buyer must have an existing healthcare FSA plan or be prepared to adopt a new healthcare FSA plan. Healthcare FSA participants will continue to seek reimbursement from the seller for the remainder of the plan year.

> *Example:* Joe works for Cellar Sales. He made a $1,200 annual election to the healthcare FSA plan that started on January 1st. On July 1st, Joe's division was sold and he became an employee of Buy Right. Joe has contributed $600 to his healthcare FSA account, but has incurred no medical expenses to date. Prior to Revenue Ruling 2002-32, Joe would have been considered a terminated employee from Cellar Sales and would have either forfeited his $600 or been able to elect COBRA continuation coverage, if applicable.
>
> The seller and buyer agree to have the transferred employees continue to participate in the seller's healthcare FSA for a specified period – generally through the end of the plan year. Joe's new paycheck from Buy Right will continue to take his healthcare FSA pre-tax reductions and deposit them into Joe's Cellar Sales' healthcare FSA account. Joe will continue to send future claims to Cellar Sales.

The buyer's new employees are not considered to have lost coverage of the seller's plan and no COBRA is offered. However, if the seller's healthcare FSA is not considered an excepted benefit, which occurs when the employer does not offer an ACA-compliant employer-sponsored group health plan or employer contributions to the healthcare FSA exceed $500 or are in excess of the participant's election, then the employer must offer full COBRA continuation coverage at the beginning of the first day of the new plan year following the current plan year. That's when former employees would lose coverage after terminating employment – which is a COBRA qualifying event.

As an example, at the start of the new plan year, a COBRA beneficiary can make a new election, and does, for $1,200. The COBRA premium can be 102% of the premium, which in this case, would be $102 per month. The participant generally has 18 months of COBRA coverage, unless special circumstances apply. These include the employee's death, divorce, or entitlement to Medicare and child's loss of dependent status; which result in a 36-month maximum coverage period.

Coverage is Transferred to Buyer's Plan

In this scenario, the facts are the same as in scenario one, except the buyer agrees to provide coverage for the new employees. Again, the buyer must have an existing plan or will adopt a new plan with salary reductions starting through the buyer's payroll account

The buyer must amend its healthcare FSA plan to provide that transferred employees who elected to participate in the seller's healthcare FSA become participants in the buyer's healthcare FSA as of the beginning of the seller's current plan year at the same level of coverage. The buyer must also amend its healthcare FSA to provide reimbursement for expenses incurred by transferred employees at any time during the seller's healthcare FSA coverage (even though expenses may have occurred prior to the sale).

Here, the buyer agrees to adopt a continuation of the seller's plan. The buyer "steps into the shoes" of the seller for purposes of the healthcare FSA plan. When the buyer assumes sponsorship of the cafeteria plan covering the employees of the seller, elections under the plan continue because there is no allowable change in status that would permit a change in the election.

All affected plan participants' accounts consisting of contributions and earlier reimbursements are transferred to the new employer. Participants will request reimbursement for expenses incurred either before or after the acquisition from their new employer. The participants enjoy uninterrupted coverage.

Example: Let's look at Joe again with a different set of facts and circumstances. Although Joe has contributed $600 to Cellar Sales' healthcare FSA plan, his balance will be transferred to his new employer. Thus, instead of sending his claims to Cellar Sales, he will turn in claims to his new employer, Buy Right.

Even if Joe incurred eligible expenses in March of the plan year, his claim would be submitted to Buy Right and reimbursed from Buy Right's healthcare FSA plan - because his account balance was transferred to the new company.

Additional Rules

Transferring the participants' accounts means just that. Unless the participant has a valid change of status, no midyear election changes are allowed because of the merger or acquisition. However, keep in mind, both the buyer and seller must have a healthcare FSA plan at the time of the sales and the FSA plans must also allow for the same period of coverage. In other words, both plans must provide coverage based on the same plan year.

Of course, in both scenarios, the seller and the buyer should document the arrangement outside of the healthcare FSA plan document and spell out appropriate financial terms. These arrangements would take into consideration contributions and reimbursements received before the merger.